*version 1.2 Dated november 2024 - angel capital association model convertible note term sheet*

**TERM SHEET FOR PRIVATE PLACEMENT OF**

**CONVERTIBLE PROMISSORY NOTES**

**BY**

**[INSERT NAME OF COMPANY][[1]](#footnote-1)**

[DATE]

This Term Sheet summarizes the principal terms of the proposed offering of convertible promissory notes (each, a “***Note***” and collectively, the “***Notes***”) by [INSERT NAME OF COMPANY], a Delaware corporation (the “***Company***”)[[2]](#footnote-2), to certain investors (the “***Investors***”). This Term Sheet is not a commitment to invest and is conditioned on negotiation of definitive transaction documents that are satisfactory to the Company and the Investors.[[3]](#footnote-3) Capitalized terms used in the text of this Term Sheet and not defined shall have the meaning set forth in Schedule A hereto.

***An asterisk (\*) and/or brackets indicate a choice of provisions. Footnotes also indicate considerations or a choice of provisions.***

|  |  |
| --- | --- |
| **Type of Security:** | Convertible Promissory Notes with the terms set forth in this Term Sheet (the “**Notes**”). |
| **Offering Amount:** | Up to the Maximum Subscription Amount in aggregate principal amount of Notes, which may be increased [at the discretion of the Company upon notice to the Investors//upon the approval of the Requisite Holders.] [The minimum investment for each individual investor is the Minimum Individual Subscription Amount, which minimum may be waived in the Company’s sole discretion]. |
| **Investors:** | “Accredited Investors” only, as defined in Regulation D under the Securities Act of 1933, as amended (“***Regulation D***”).[[4]](#footnote-4) |
| **Type of Offering:** | The Company will conduct this offering as a private placement in reliance on the safe harbor exemption provided by Rule 506(b) of Regulation D. |
| **Issue Date/Closing:** | The initial closing shall be as soon as practicable following the acceptance of aggregate subscriptions for the Minimum Subscription Amount (the “***Initial Closing***”).[[5]](#footnote-5) Thereafter, the Company may hold rolling closings until the earlier to occur of (i) the issuance of the Maximum Subscription Amount in principal amount of Notes, or (ii) the Offering Termination Date which date may be extended [at the discretion of the Company//at the discretion of the Company and upon notice to the Investors//upon the approval of the Requisite Holders.] Each closing shall be referred to herein as a “***Closing***”. |
| **Interest:** | The Interest Rate per annum calculated on the basis of a 365-day year. Interest shall accrue and not be paid currently. |
| **Demand Maturity:** | The “***Maturity Date***” shall be the date on or after the Maturity Trigger Date when the Requisite Holders demand repayment of the outstanding principal and accrued and unpaid interest on the Notes. Upon the Maturity Date, the outstanding principal and accrued and unpaid interest on the Notes will be due and payable unless the Notes have been previously converted.[[6]](#footnote-6) See also *Repayment or Conversion on or after Maturity Trigger Date.* |
| **Prepayment:** | The Company shall not prepay any Note without the prior written consent of the Requisite Holders. Any prepayment must be pro rata based on the principal amount of each Note. |
| **Security/Subordination:** | The Notes will be unsecured obligations of the Company and shall be subordinated to the Company’s indebtedness for borrowed money (to banks, commercial finance lenders, equipment lessors or other lending institutions).[[7]](#footnote-7) |
| **Conversion:[[8]](#footnote-8)** |  |
| *Mandatory Conversion upon a Qualified Equity Financing:* | At any time prior to a Demand Date or conversion of the Note upon a Sale of the Company, in the event of a preferred equity financing (in one or a series of related closings) raising new money equal to an aggregate amount of at least the Qualified Financing Amount (a “***Qualified Equity Financing***”)[[9]](#footnote-9), the Notes shall be converted to the preferred stock issued in such Qualified Equity Financing in accordance with this section. The number of preferred shares to be issued upon such conversion shall be equal to the quotient obtained by dividing the amount of principal and accrued interest outstanding under such Note immediately prior to the closing of such Qualified Equity Financing by a price per share equal to the lesser of (i) the Discount Percentage multiplied by the lowest price per share paid by the investors in the Qualified Equity Financing; or (ii) an amount obtained by dividing (x) the Valuation Cap by (y) the aggregate number of outstanding shares of the Company’s Common Stock immediately prior to the closing of the Qualified Equity Financing (assuming full exercise and conversion of all securities exercisable for or convertible into Common Stock including all options outstanding and all shares of Common Stock reserved under any equity incentive plan, the Notes, any other convertible indebtedness, SAFEs or similar securities)[[10]](#footnote-10) (such calculation in clause (ii), the “***Post-Money Price***”).Shares issued to the Investors as a result of conversion in connection with a Qualified Equity Financing shall have the same rights, preferences, and privileges, contractual or otherwise, as those applicable to shares issued in the Qualified Equity Financing other than with respect to: (i) the per share liquidation preference and the conversion price for purposes of price-based anti-dilution protection[[11]](#footnote-11); and (ii) the basis for any dividend rights.[[12]](#footnote-12) |
| *Conversion/ Repayment upon a Non-Qualified Equity*  *Financing:* | At any time prior to a Demand Date or conversion of the Note upon a Sale of the Company, in the event that the Company consummates a bona fide equity financing that does not qualify as a Qualified Equity Financing (a “***Non-Qualified Equity Financing***”), upon the consent of the Requisite Holders, all Notes shall convert into the same class of securities sold in such Non-Qualified Equity Financing on substantially the same terms as conversion upon a Qualified Equity Financing as provided above. [[13]](#footnote-13) |
| *Payment upon a Sale of the Company:* | In the event of the closing of a Sale of the Company (as defined below) while the Notes are outstanding, the Investors shall be paid or issued consideration equal to the greater of (i) cash equal to the Sale Multiple times the aggregate amount of accrued but unpaid interest due pursuant to the Notes plus unpaid principal amount due under the Notes out of the assets of the Company available for distribution to its stockholders before any payment shall be made to the holders of common stock and any outstanding class of Preferred Stock (if applicable) and (ii) the consideration the Investors would receive if the unpaid principal amount and accrued but unpaid interest due under the Notes was converted into the most senior class of equity securities of the Company immediately before the Sale of the Company, at the Post-Money Price. The Investors shall receive notice of a Sale of the Company not less than ten days prior to the Closing which notice shall include a summary of the transaction and the calculation of the amount due to Investors upon the Sale of the Company. Upon payment or conversion, each Note shall be deemed satisfied in full and the Note shall be canceled.“***Sale of the Company***” shall mean either: (a) a merger, acquisition or other transaction not intended solely to provide financing for the Company, after which current shareholders of the Company do not control more than fifty percent (50%) of the surviving entity; (b) the closing of the transfer, in one transaction or a series of related transactions to which the Company is party, to a person or group of affiliated persons (other than an underwriter of this corporation’s securities), of the Company’s securities if, after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company (or the surviving or acquiring entity); or (c) a sale, exclusive license, transfer or other disposition of all or substantially all of the assets of the Company.[[14]](#footnote-14) |
| *Repayment or Conversion on or after Maturity Trigger Date:* | Upon the request of the Requisite Holders at any time on or after the Maturity Trigger Date (a) all Notes shall be paid in full or (b) the Company shall convert all Notes into the most senior class of stock previously issued by the Company at the Post-Money Price. The right of the Investors to convert their Notes shall survive the Maturity Trigger Date. Until such request is made, the Notes shall remain outstanding and the right to demand conversion shall continue, until such time as a demand is made or the Notes are otherwise converted.[[15]](#footnote-15) |
| **Amendments, Waivers, etc.:** | Any term of the Notes may be amended and the observance of any term of the Notes may be waived (either generally or in a particular instance and either retroactively or prospectively), with the written consent of the Company and the Requisite Holders. Any modification, amendment or waiver that (a) reduces the principal amount, or (b) affects an Investor in a materially disproportionate manner relative to its effect on any other Investor shall also require the consent of each Investor affected as a condition to the effectiveness thereof. |
| **Customary Provisions:** | Customary provisions for events of default[[16]](#footnote-16) and representations and warranties.[[17]](#footnote-17) |
| **Costs of Counsel:** | [Reasonable fees and expenses of counsel to the Lead Investor, up to the Legal Fee Cap, will be borne by the Company and paid at the Initial Closing.//The Company and each Investor will bear their own expenses.][[18]](#footnote-18) |
| **[Board Observer:]** | [The Requisite Holders may designate one individual to attend meetings of the Company’s Board of Directors as a non-voting observer.][[19]](#footnote-19) |
| **[Protective Provisions[[20]](#footnote-20)]:** | [So long as at least 50% of the original principal amount of the Notes is outstanding, the Company will not, without the consent of the Requisite Holders, either directly or indirectly by amendment, merger, consolidation or otherwise:   1. make any substantial change to the business of the Company; 2. sell, assign, license, pledge or encumber material assets, technology or intellectual property, other than licenses granted in the ordinary course of business; 3. purchase or redeem or pay any dividend on any capital stock, other than stock repurchased at cost or less from former employees and consultants in connection with the cessation of their service; 4. enter into or amend any related-party transaction (including material increases to the compensation of any founder); or 5. create or authorize the creation of any debt security, if the aggregate indebtedness of the Corporation and its subsidiaries for borrowed money following such action would exceed $[\_\_\_\_] other than equipment leases, bank lines of credit or trade payables incurred in the ordinary course.] |
| **Use of Proceeds:** | The Company shall covenant to use the proceeds from the sale of the Notes for the Use of Proceeds, which shall not include in any instance repayment of founder loans or deferred compensation. |
| **Participation Rights:** | Investors will receive the right to purchase their pro rata share of new securities issued by the Company until the conversion or repayment of the Notes, other than (i) options issued pursuant to any equity incentive or similar plan of the Company and (ii) convertible securities issued or issuable to (A) banks, equipment lessors, financial institutions or other persons engaged in the business of making loans pursuant to a debt financing or commercial leasing or (B) suppliers or third-party service providers in connection with the provision of goods or services. [[21]](#footnote-21) |
| **Information Rights:** | Subject to customary limitations on competitors and confidentiality, each Investor shall be entitled to receive:   1. unaudited annual financial reports within 90 days of the end of the fiscal year (audited if Company elects to produce); 2. quarterly unaudited financial summary and management summary business updates on progress and accomplishments by the 15th calendar day of the following month; 3. upon request, an updated capitalization table; 4. upon request, information required by Section 4(a)(7) of the Securities Act of 1933, as amended; and 5. inspection rights as provided under Delaware Code Title 8. Corporations § 220.[[22]](#footnote-22) |
| **IP Assignment Agreement:** | All founders [,contractors,] and employees have entered into confidentiality and proprietary information and invention assignment agreements, in a form previously disclosed to the Investors reasonably acceptable to the Investors, and the Company will covenant to have every future employee [and contractor] enter into a substantially similar agreement upon joining the Company.[[23]](#footnote-23) |
| **[Most Favored Nations:]** | [So long as any Notes remain outstanding, if the Company offers convertible notes, SAFEs or other convertible instruments with economic terms superior to those in the Notes, the Investor may elect to exchange all of its Notes then held by it for the securities issued in such subsequent financing based on the then outstanding principal amount of the Note, plus any accrued but unpaid interest thereon, and the effective price at which such securities are sold in such subsequent financing.][[24]](#footnote-24) |
|  |  |
| **Governing Law:** | State of Delaware |

SCHEDULE A

DEFINED TERMS

Discount Percentage: \_\_\_%[[25]](#footnote-25)

Interest Rate: \_\_\_\_\_ percent (%)[[26]](#footnote-26) [compounding //cumulative interest][[27]](#footnote-27)

Lead Investor (if applicable): \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Legal Fee Cap (if applicable): $\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Maturity Trigger Date: \_\_\_\_\_\_\_\_\_\_\_\_\_\_ [[28]](#footnote-28)

Maximum Subscription Amount: $\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Minimum Individual Subscription Amount: $\_\_\_\_\_\_\_\_\_\_\_\_\_\_[[29]](#footnote-29)

Minimum Subscription Amount (if applicable): $\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Offering Termination Date: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_[[30]](#footnote-30)

Qualified Financing Amount: $\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Requisite Holders: the Investors holding at least\_\_% of the aggregate outstanding principal amount due under the Notes.[[31]](#footnote-31)

Sale Multiple: \_\_\_ times (\_\_\_x)[[32]](#footnote-32)

Use of Proceeds: [General working capital purposes of the Company][The following activities: (1) \_\_\_\_\_\_\_\_\_\_\_\_\_\_, (2) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, and (3) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.][[33]](#footnote-33)

Valuation Cap: $\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. This term sheet for Convertible Promissory Notes was created by the Angel Capital Association Model Convertible Note Task Force as a starting point example made available for general information only and is not intended to, and does not, constitute the provision of legal advice. **Always consult your own legal counsel.** [↑](#footnote-ref-1)
2. This term sheet assumes the issuer is a Delaware corporation but may also be used by limited liability companies **with appropriate modifications**. If the issuer is registered in another state or is not a corporation, analysis must be undertaken as to any revisions to these terms needed to comply with such state’s laws, laws relating to limited liability companies and/or tax consequences. [↑](#footnote-ref-2)
3. Generally, term sheets involving multiple investors are unsigned and serve as a drafting guide for the definitive agreements. However, if there is a strong lead investor, the term sheet often is signed with certain rights for the lead including exclusivity and approval of other investors. [↑](#footnote-ref-3)
4. If there is a lead investor, especially if the lead investor is an institution, they may want to have rights to agree on which other investors participate in the round. If so, add: “Other Investors as may be mutually agreed upon by the Lead Investor and the Company.” [↑](#footnote-ref-4)
5. Investors may want to be sure that the raise is large enough to provide the Company funding for a period of time or to accomplish certain milestones. A provision could be added to have a segregated account or an escrow so that funds can be collected pending the minimum subscription being reached. This is not common in a convertible note financing. Language may be added “Funds shall be held by the Company [in escrow] [in a segregated account] pending the Initial Closing.“ [↑](#footnote-ref-5)
6. The note is structured as a demand note to address two issues. One is the recent ruling in Nevada in which the court forced payment at maturity rather than allowing a convertible note to convert. The other is to obviate the need for repeated requests to extend the maturity date of a convertible note, though the issuer may choose to request extension of the Trigger Date in any case. See *Toptal, LLC et al. v. Denis Grosz, et al*., CV20-00555, Second Judicial District Court, State of Nevada. The case is on appeal. [↑](#footnote-ref-6)
7. A convertible note may be secured if needed to encourage investment, but typically they are unsecured. Consideration should be given as to whether the Company’s assets upon a default would bring back sufficient return to justify the added expense of creating a secured interest. [↑](#footnote-ref-7)
8. Subject to certain limitations and eligibility criteria, Section 1202 of the Internal Revenue Code provides for a 100% exclusion from federal taxable income of gains recognized on the disposition of certain stock in qualifying corporations that has been held for at least 5 years. Stock acquired upon the conversion of a note may qualify. However, the required 5-year holding period for Section 1202 purposes would not begin until after the note is converted to shares in a C corporation. [↑](#footnote-ref-8)
9. Consideration should be given to the amount raised in the convertible note round (and taking into consideration all convertible securities already issued) as a percentage of the proposed Qualified Financing Amount. The new money investors may not want the holders of the convertible securities to dominate the round. [↑](#footnote-ref-9)
10. This calculation of the price based on the Valuation Cap is a post-money calculation, which means that the cap is calculated immediately prior to the next equity round including the conversion of all convertible securities outstanding at that time, including the notes issued under this Term Sheet. A post-money calculation for a convertible note has historically been in the minority, but data shows has been increasingly used in the past year for convertible notes and almost all SAFEs. An alternative method is to use a pre-money calculation, which “excludes the Notes and other convertible indebtedness and SAFEs or similar securities (such calculation in clause (ii), the “***Pre-Money Price***”)” from the number of shares used to determine the price per share used for calculation of shares received by the investor in the conversion. To replace the Post-Money with a Pre-Money calculation, remove “the Notes, any other convertible indebtedness, SAFEs or other similar securities (such calculation in clause (ii), the “***Post-Money Price***”)” and replace that phrase with the language in the preceding sentence of this footnote – then replace “Post Money Price” with “Pre-Money Price” elsewhere in this term sheet. The issuer and investors should review pro forma capitalization tables to understand the effect of dilution using each method. The post-money calculation is more favorable to investors as it results in a lower price per share upon conversion, but is in line with the majority post-money calculations for SAFEs. [↑](#footnote-ref-10)
11. The conversion of the Notes creates a shadow series of preferred stock due to the different per share liquidation preference and conversion price resulting from the lower purchase price of the stock. [↑](#footnote-ref-11)
12. Priced equity financings sometimes provide enhanced information, participation, co-sale/right of first refusal, and other rights limited to “Major Investors” whose holdings exceed a specified size threshold. Investors may consider adding language requiring the Company to provide the shares issued upon conversion with Major Investor rights regardless of the size of the holdings. [↑](#footnote-ref-12)
13. Another alternative is to also allow individual Investors to convert upon a Non-Qualified Financing. Also, other conversion events can be considered such as revenue or other milestones. [↑](#footnote-ref-13)
14. Or conform this definition to the definition of “Deemed Liquidation Event” or the equivalent if it is in the Certificate of Incorporation. [↑](#footnote-ref-14)
15. In addition, the Note may provide for an individual investor to elect to convert into an existing class of stock. It is not recommended to allow one investor to be able to call for repayment without the round being repaid. [↑](#footnote-ref-15)
16. Note that a minority of convertible notes currently include acceleration for default. However, the task force decided that acceleration upon a narrowly defined list of defaults by the Company is a reasonable investor protection. The form of Note includes acceleration upon the Company’s failure to comply with any obligation set forth in the Note (subject to a notice and cure, if applicable) and the Company’s insolvency. [↑](#footnote-ref-16)
17. Note that a minority of convertible notes currently include representations though they are frequently contained in a Note Purchase Agreement. However, the task force decided that basic Company representations are best practices and benefit the Company and the investors. The form of Note includes representations on formation, authority, enforceability, compliance with laws, intellectual property, no related party transactions, no litigation or claims, capitalization table, and either a representation on financial statements provided or no material liabilities. [↑](#footnote-ref-17)
18. If there is a lead investor, especially if the lead investor is an institution, it is typical to have reimbursement of legal fees up to a reasonable cap. [↑](#footnote-ref-18)
19. A Board observer or Board seat is provided in slightly less than half of convertible debt financings and often depends upon the size of the financing according to the ACA Angel Funders Report. A Board seat is provided less frequently than a Board observer position. The following language can be inserted if a Board seat is agreed: “The Board of Directors shall consist of [\_\_\_\_] directors, one of whom shall be designated by the Requisite Holders so long as 50% of the original principal amount of the Notes remain outstanding.” If the Note round has the right to designate a Board member, a provision requiring Directors & Officers insurance and an indemnity agreement for that Board member should be included. Attention must also be given to recent developments in Delaware law which may require the power to appoint the Board to be included in the Certificate of Incorporation. [↑](#footnote-ref-19)
20. Most convertible note financings do not have protective consent rights for the investors, so, if included, a balanced approach should focus on economic rights which would directly adversely affect the investors holding the Notes rather than extensive control of company affairs. If not in the note, these can also be included in a side letter for the lead investor, for example, as an alternative. [↑](#footnote-ref-20)
21. Currently, participation rights are often included in side letters for certain investors. The Task Force has chosen to include them in the Note as a best practice and to simplify documentation. [↑](#footnote-ref-21)
22. Currently, information rights are often included in side letters for certain investors. The Task Force has chosen to include them in the Note as a best practice and to simplify documentation. To ensure that investors continue to have access to Company information after a conversion and despite “Major Investor” ownership requirements, Investors may consider adding a requirement that the Company execute a Management Rights Letter with the Investor upon conversion. [↑](#footnote-ref-22)
23. This is an important aspect of due diligence for angel investment rounds that is often missed, so the Task Force has decided to include it in the Note form. [↑](#footnote-ref-23)
24. This most favored nations provision is not often seen in note financings, but it may be considered. [↑](#footnote-ref-24)
25. Consider in conjunction with interest rate. Data from Carta’s State of Pre-Seed Q1 2024 Report (the “Carta Report”) shows that a 20% discount is the median convertible note discount. [↑](#footnote-ref-25)
26. Usually 5-9% but may change in consideration of the interest rate environment. The Carta Report shows that interest rates have increased in the past year with average interest rates at 7.6% in Q1 2024. [↑](#footnote-ref-26)
27. The Task Force believes cumulative interest is more common but has no data to confirm this. [↑](#footnote-ref-27)
28. Insert a date - Usually 12 to 36 months from the date the first Note is issued. [↑](#footnote-ref-28)
29. In a large raise, the Company should be cautious about allowing investors for small amounts as it creates a capitalization table with too many investors and risks that some are not truly accredited investors, which is required for certain Securities Act exemptions. VC and private equity investors frequently disfavor investment in a company with many small investors in earlier rounds. [↑](#footnote-ref-29)
30. Unless the Company has most of the round circled in advance, allow more time than predicted as fundraising can be a long process. [↑](#footnote-ref-30)
31. Usually a majority. The Lead Investor, especially if an institution, may insist upon consent as well. [↑](#footnote-ref-31)
32. Usually between 1.0 and 3.0 times. [↑](#footnote-ref-32)
33. Use general working capital purposes unless specific milestone activities are targeted for the use of proceeds. [↑](#footnote-ref-33)